RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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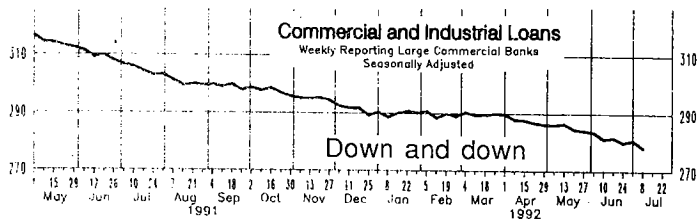
**Aug. 5, 1992** **LETTER 1101**

**GEORGE'S SECRET:** I'm George Bush, and nothing's coming up right. I'm tired, I'm cranky, I'm disgusted. They're killing me, they're attacking me on everything -- on Iraq, on Quayle, on the deficits, on the federal debt, on my anti-abortion stand, on my "read my lips" disaster, on Iran-gate. This morning I stared at myself in the mirror. I'm 68 years old and I'm looking 75. Damn it, I've had enough, I don't need this, I want out. But I can't just quit like that little squirt, Perot, did. I've been brought up to be a winner. So how do I get out of this maddening situation? Hey, no problem, I just keep doing exactly what I'm doing. I won't change a thing. Come November, I'll be a free man, an honored ex-president. Ah, freedom at last. I can almost taste it.

**WHAT'S THIS?** The Fed reports that as of the end of June the banks actually held more in US securities ($607 billion) than they held in commercial and industrial loans ($598 billion). This is the first time this has occurred in 27 years! The Fed forces rates down to the basement (thereby reliquefying the banks) and the banks return the favor by loading up with the Treasury's paper. So now the banks are up to their eyeballs in bonds. But the banks aren't making loans, and the nation's in a "contained depression."




Interest rates have collapsed, consumers are gloomy, and nobody's taking out loans. That's exactly what happened during the Great Depression -- with one big difference. Then the stock markets were crashing but today the markets are bullish. So how are the two periods different? As I interpret it, today's stock market is saying that somewhere ahead business is going to pick up and people will start buying again -- unlike the situation during the 1930s.

If that's what the market is telling us, then as soon as there's a first sign of an economic upturn, look for a major top in the bond market with interest rates rising again. In the meantime, however, we've witnessed a panic to buy notes and bonds and lock in interest rates.

All right, the banks (and the public) are loaded with bonds. But what happens when interest rates finally do turn up? Maybe the biggest panic out of bonds we've ever seen. We'll also see a topping out of the bull market. Remember, the stock market held or advanced all during the "contained depression" period when interest rates were being forced down. The stock market will head down when the economic statistics finally turn up.

**BIG PICTURE:** With the exception of the US, the stock markets of the world have been slumping. Japan's Nikkei stock index, which topped out just above 39,000 in 1989, broke last week to a new low just above 15,000 (this despite a half percent cut in their discount rate). As for the rest of the nations, the markets of France, Switzerland, Germany and Britain have been sliding since May, while Japan, Sweden and Denmark has been sinking since January. More recently, the declines have accelerated. Internationally, it's not a very happy picture.

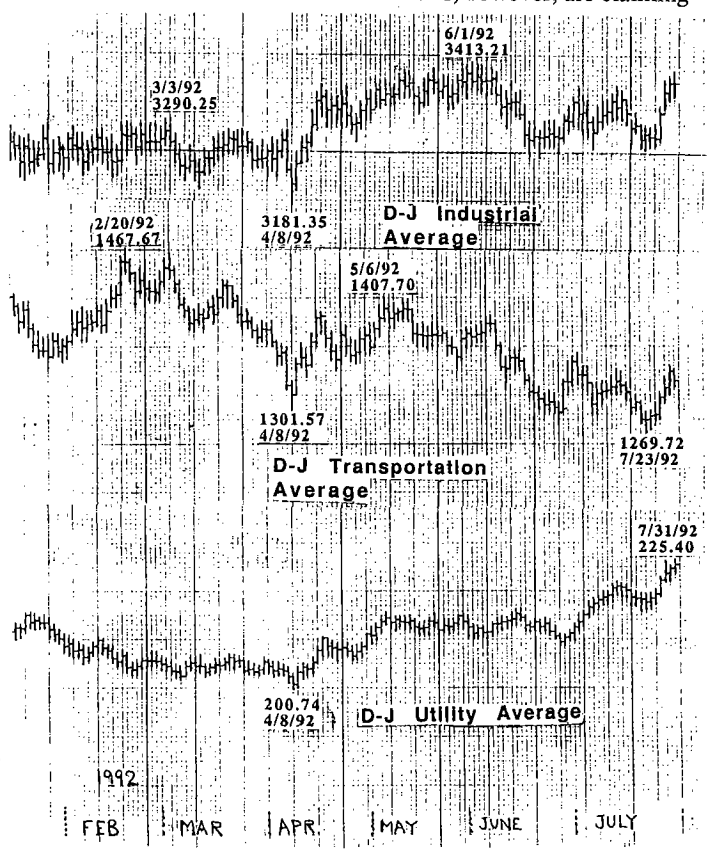
**July 24 DJIA 3285.69; PTI 3528; A-D Ratio -10.20**
**July 17 DJIA 3393.76; PTI 3551; A-D Ratio -9.17**
**Dow Yield: 3.07%; Dow Price/Earnings: 61.6**
**Dow 200-day MA: 3215; Dow 30-day MA: 3301**
**Dow Times Book Value: 2.54; PTI 89-day MA: 3490**
**Percentage of Undervalued Blue-chips: 9%**

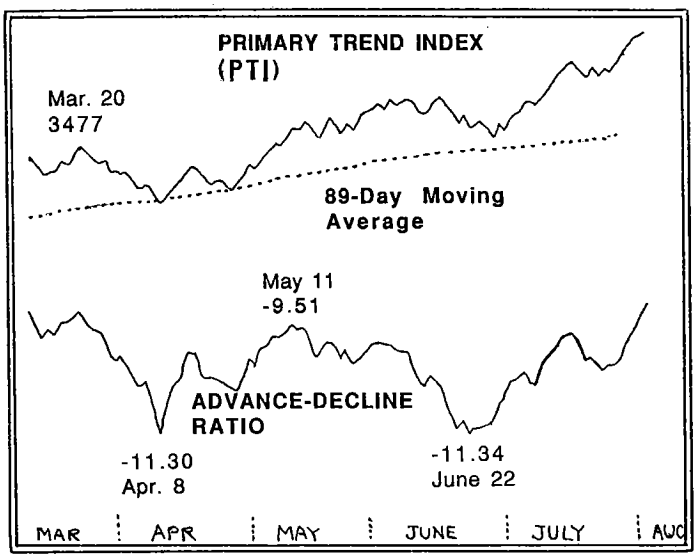
Furthermore, for the first time since the Great Depression almost all the nations in the northern hemisphere are in various stages of recession.

Here in the US the deficits (federal, state, and city) continue to mount. At the same time, layoffs continue, unemployment remains high, and Americans pay down debt while buying only what they need and then at bargain prices. Discount chains and volume warehouses are today's retail heros.

The stock market: To put it in simplest terms, the stock market has been trading (rising) off the collapsing US interest rates (as rates decline, the market puts a higher capitalization on stocks). Up to last week the brightest spot in the Wall Street picture has been the action of the D-J Industrial Average. But on July 29 both the NYSE Composite and the S&P 500 rallied to all-time highs. Argue with it if you want, but to me that action confirms the fact that it's been a bull market (although admittedly a ragged one) all along.

Under the guise of a "Teflon Dow," a large number of stocks have already been battered. In fact, the widely publicized figure is that 40% of the 5,000 listed stocks have been downed by 30% or more. On that basis, some analysts are referring to 1992 as the "year of the hidden bear market," and it's true that most people who bought stocks in 1992 are still "under water." Bulls, however, are claiming






that the "internal correction" is over, and now it only remains for the Dow to confirm the NYSE and S&P Composites by advancing to new record highs (the all-time Dow high was **3413.21**).

At this point pessimists, bears and sceptics, must face one fact -- you don't get new highs in the broad composite averages (NYSE & S&P) in a bear market. No, you may not love this market, you may even be losing money in this market, but it's still a primary bull market. When this market finally turns bearish, you won't have to guess about the trend, believe me, you'll know it!

Classification: The truth about this market is that it's been a strange affair, and for many months it's been almost impossible to identify exactly what we were looking at. However, I emphasized that the safest course was to rely on the Dow Theory thesis which states, *"The trend is taken to remain in force until proved otherwise."* And there's been no "otherwise."

In other words, as stated in Letter after Letter, this is still a primary bull market. And I will continue to label it as such unless we get (1) a Dow Theory bear signal or (2) unless my PTI drops into a decisive bear trend. Neither of the above has occurred, and, in fact, the Dow is currently about 200 points above its critical April 8 level of 3181.35, and my PTI is currently at new record highs.

Safety: Just because the Dow Theory classifies the trend as bullish, that does not mean that we have to be loaded with stocks. Because of the extreme overvaluation of the current market, I feel that the risk/reward in owning stocks is poor here. In other words, the risks are high, and the potential rewards are not that attractive.

The Rule: Remember Russell's first rule of investing, *"Above all, don't lose money."* With that in mind, it's well to remember that in the past, when yields on the Dow and the S&P have been this low, the result has always been some type of bear market. It may be different this time, but as I say, the risk/reward in buying stocks when the Dow yields 3% is poor. Investors who bought stocks or mutual funds during the first quarter of this year, have, for the most part, found that out already.

Projections vs. Action: Last year Robert Doll, the portfolio manager of Oppenheimer Special and Target Funds drew a lot of attention by forecasting that the Dow should reach 7700 by the year 2000. How did Doll arrive at that figure? He based it on the thesis that the S&P 500 has shown an annual growth rate of 10.1% since 1926. Therefore, Doll figured that if this growth rate continues, the Dow should be at 7700 by the end of this century.

Sounds good, but I wouldn't bet on it. Things change, including growth rates. For instance, it's only been in the last five years that the budget deficits and the federal debt have boomed out of sight. That's got to influence the growth rate of stocks. Now consider this: the high for the Dow in 1987 was 2722. Today the Dow is at around 3320. That represents an increase of **22% over five years or roughly 4.4% a year.** That hardly fits in with the 10% a year range that Mr. Doll has projected. No, things change, and projections are just that -- projections.

I think projections are interesting, but I prefer to rely on simple market action. So let me put it this way -- as long as I don't get a Dow Theory bear signal and as long as my Primary Trend Index continues in its bullish mode, I'll simply figure that the path of least resistance for the market is up. How far up? I don't know, nobody knows. It's enough for me to know the direction.

When a full-fledged bear market finally does arrive, how far will it carry the Dow on the downside? A tenet of the Dow Theory states, *"Neither the duration nor the extent of a primary movement can be predicted in advance."* For instance, how many, in their wildest dreams, guessed in September 1929 that the Dow would lose 89% of its value. Or how many of us in 1974 guessed that the Dow would appreciate by 491% by 1992. I sent out a special mailing on December 8, 1974, calling the bottom -- but in no way did I think that the Dow would be above 3400 eighteen years later in 1992.

No, my work says that the bull trend is still in force, and if we do get a bear signal I can tell you that there isn't a man alive who can predict how long it will last or where that bear will take the market.

**Q & A:** Question: What's the Fed doing and why? Answer: The Fed is intent on creating low, low interest rates. After all, there's an election coming up and what else can the Bush Administration do (oops, I forgot, the Fed is totally independent) but pressure the Fed for low, low interest rates. The Fed has obliged: it has dropped rates (Fed funds, Discount rate) 23 times over the past three years.

Question: What could halt the Fed's low interest rate parade? Answer: There are only two things that could interrupt the Fed's low interest rate policy: (1) a run on the dollar, and (2) a persistent rise in gold. Either one would shake the bond and stock markets and push interest rates higher.

And that's exactly what was happening up to a few weeks ago. In fact, on July 18-20 things started to get "out of hand." Gold jumped to 360 on the December contract and the dollar was in a free fall. That action frightened the Fed and the central banks. On July 21 the Fed along with 13 other central banks intervened in the foreign exchange market -- meaning they bought dollars. The dollar shot up by 2.7% as the currencies sold off. The market stabilized, at least temporarily.

Question: What's the meaning of the near-record spread between short interest rates and long rates? Answer: The huge differential represents the money market's fear of the future degradation of the dollar. The market is saying that bonds maturing in 30 years will be paying off in "depreciated junk dollars." For this reason bond investors are demanding that the US government pay them a premium for purchasing its long-term paper. That premium is the spread between short and long rates.

Question: Why isn't the money supply increasing as the Fed would like? Answer: In order for the money supply to increase, banks have to make loans. And the banks are very reluctant to make loans.

Question: Why aren't the banks making loans? Answer: Why in hell should they? A bank can go out and borrow money at 3%, then invest it in guaranteed US paper yielding 5.5% to 7.4%. If you could borrow at 3%, would you buy government paper or would you mess around with complicated or risky business loans and mortgages?

Question: If the government continues to degrade our currency, won't we see the time when nobody will buy the government's debt? Answer: Good question, but there will always be someone to buy US debt. That someone is the Fed. It's a case of the government buying its own manufactured paper with its own manufactured currency. Of course, when the Fed buys government debt that process is called "monetization" and it's an inflationary process. But the government will accept any amount of inflation rather than become insolvent.

Question: Then as the total US federal debt builds, as the deficits continue to accumulate, as the government is forced to buy more and more of its own debt, won't that simply destroy the dollar? Answer: Sure it will. And that's why the dollar has been so weak, and that's why there's a record yield spread between short and long rates, and that's why gold has been moving up.

Sophisticated investors are looking ahead, and they don't see any way out of the debt/deficit mess the government has gotten itself into. As a result, investors have been moving out of dollars and into the major hard currencies and into gold. I expect this movement to accelerate in the months ahead.

Question: But can't the central banks halt the decline of the dollar? Answer: They can -- temporarily. But when a nation runs huge deficits year after year, the natural forces of supply and demand take over. We might call this a primary force -- it's fundamental. When you run deficits and compound those deficits year after year either your nation goes bankrupt or your currency goes bankrupt.

What we're seeing is the dollar slowing heading towards bankruptcy. The central banks can come in and manipulate the market, they can hold back the trend for a while, but in the end they can't stop the primary trend from expressing itself. We saw a dramatic example of that in the '70s when the US government tried to halt the rise in gold. They talked gold down, they sold gold, they did everything they could, but gold beat the Treasury, the Fed and the administration. Gold rose from the 40s to over 800. Ironically, the Treasury still values its store of gold at the old price of 42.22 instead of marking it up to market value.

Einstein stated that there are two things that are infinite -- space and human stupidity. The US government's policy towards gold and the dollar are living proof of Einstein's thesis.

**HOW NOW, DOW?** Collective earnings on the Dow have been hit hard. The latest update from *Barron's* shows total Dow earnings (including deficits) at $53.67. With dividends of $104.27, this means that dividends are roughly twice what the collective Dow earns. Now, obviously, this can't go on.

The stock market trades on perceptions and future estimates, rather than on today's facts. It's clear that the market today is priced to reflect a major boom in earnings. So to make it easy, with earnings today for the Dow at $53.67, let's say they triple to $161. At earnings of $161, the current Dow dividend payout of $104.27 would be roughly 65% of earnings. This is actually a very high payout, when we consider that the normal Dow payout for the Dow over the years has been around 50%.

So my conclusion is that Dow earnings in the future should quintuple to $215 to justify today's Dow price level of around 3380 and today's dividend yield of 3.17%. What are the chances of a quintupling of Dow earnings over the next few years? My guess -- little or none.

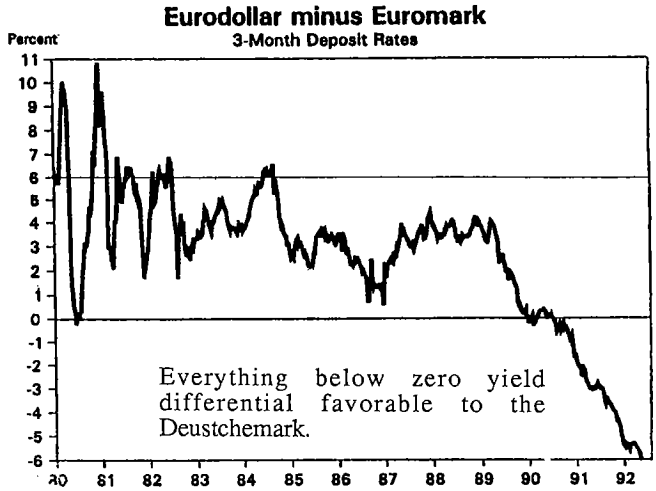
Conclusion: ultimately, sanity always returns to the stock market. The Dow is like a rubber band, stretching first above and then below its "central value." At present we're seeing the Dow stretched far above its central value.

**INVESTMENT POSITION:** As you may have suspected, the bull remains in the box. In fact, I've included a bull that's a little tougher than the recent bulls. With the NYSE and the S&P Composites in record high ground, the box deserves a tougher, meaner bull. Strange though, that the Dow, which has been the strength of the market all during

1992, hasn't confirmed the new highs in the Composites. But then, it's been a strange market all around (and the Transports still aren't close to confirming anything).

Boy, is this a tough section to write. I've been warning about the dollar for months, and yes, the dollar's been collapsing. Is the dollar oversold now? Yes, but is the dollar going still lower? Maybe, maybe to all-time lows but at this writing it's too early to tell.

After all, the spread between dollar yield and foreign currency yields continues to be ridiculous. Last time the dollar was at these lows the yield spread in favor of the Deutschemark was 2.5%. Today the yield spread in favor of the mark is at 6%. On that basis, is the dollar a buy? Doesn't look like it. Study this chart of the yield differential.




I've been putting money in the Benham European Government Bond Fund [(800) 321-8321]. I've also been buying foreign bonds (British, German, French, Spanish and ECUs). They are all yielding in the 8.4% to above 9% with Spanish short-term paper yielding 12.7%. As for 10-year bonds, yields are 13.2% in Italy, 11.75% in Spain, 9.73% in Sweden, 9.1% in Denmark, 9.04% in the UK, 8.85% in France, 7.97% in Germany. As yields on US paper go down, down, down, the attraction of European government paper becomes irresistible -- at least to me it does. To my mind, the only plus for the dollar is that it's oversold, and that it's been going down for so long. Where do you buy foreign government paper? At your local broker (I use Merrill Lynch).

How about purchasing power parity, the fact that the dollar is "cheap" in that it buys so much here vs. what an equal amount of a foreign currency buys in another nation? Forget PPP, it's the high interest rates courtesy of the Bundesbank that's making the difference. With European currencies all tied to the Deutschemark, when the Bundesbank plays it tough, Europe's interest rates stay high.

As to US stocks or even world stocks, personally, I think the more intelligent move is to European bonds. Furthermore, the stock markets of the world are heading down. A world slowdown or a global recession could be what's happening. If so, in due time the pressure will be for European rates to come down, which will push government bond prices up.

Gold seems to be consolidating after its recent run-up. The December 380 options that I bought for $1.00 have been as high as $3.50 and are around $2.50 now. I'm hoping for gold at 600 by November 1 (just day-dreaming). I told Faye that if gold is 600 by November 1, I'll buy her a new Mercedes. In the mean time, she's not selling her bicycle.

Did you know the world's largest capitalization stock is Royal Dutch Petroleum? I just bought a little for my kids. Microsoft has a huge top, and I was almost tempted to sell uncovered options on it (I didn't because that's not my cup of tea). But this is one

expensive stock, selling at about 18 times sales (not earnings). Bill Gates (the CEO) may be a billionaire and a computer genius, but is he really happy? Yeah, probably.

John Templeton (the world's most famous global bull) has sold his huge mutual fund empire to Franklin Funds. Does he know something? Or is he just cashing out? Templeton says that suddenly everyone was taking an interest in the fact that he's 78 and not getting any younger. Another possible factor: the US is getting ready to put a lot of new regulations into effect regarding mutual funds. One thing they can change -- the funds' outrageous practice of charging shareholders for a fund's advertising expenses. To my mind, that's a total rip-off.

**NOTES & QUOTES:** Don't miss the editorial in the Jul. 27 issue of *Barron's*. Crux of it: the Fed's main job is to stabilize the dollar, everything else is secondary. Instead, the Fed under Greenspan has been selling the dollar down the river. A second excellent article appears in the same *Barron's,* in the International Trader section. Bruce Campbell, a London money manager, is interviewed. Over the next five years Campbell sees US nominal earnings growth for stocks of no more than 2% to 3% compounded per annum. With dividend yields at 3%, he sees nominal total return of 5% to 6%. Subtract 3% for inflation and you're left with a real return on stocks of 2-3% which Campbell calls totally inadequate. Therefore, he believes stocks have to fall at least 25% from current level, probably more.

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Writes Anthony Lewis, star writer on the *NY Times* editorial board, *"The Democratic Convention, underneath the hoopla, showed us a profound change in American politics and culture. Women; they are the change. Their new status in society -- their political power -- was the message not to be missed at this convention.*
*Bill Clinton has to rely heavily on women voters. He comes to them, as he told the rally -- as the 'grandson of a working women, the son of a single mother, the husband of a working woman . . . I have learned that building up women does not diminish men.'"*

I totally agree with Clinton's view on women. I asked my wife, Faye (who's a pretty smart corporate lawyer) what percentage of women she thought would cast their votes based on free choice. She guessed 50%. I asked her what percentage would vote based on anti-abortion. She guessed 15% to maybe 20%. I asked Faye which president and vice president she thought most women would vote for. She said Clinton and Gore.

Russell opinion: I believe the women's vote could swing this election. On that basis, I've got to believe Bush is in deep trouble. He's got the pro choice vote against him, he's got the baggage of Quayle against him, he's got the economy against him, he's got the Saddam Hussein situation against him, and he's got his age against him (by that, I mean he looks used-up, he looks unhappy, he sounds defensive). Lastly, Clinton and Gore (very shrewdly) have taken on the youthful, sexy, up-beat aura of John Kennedy, and that is bound to attract young voters. Note: Bush's collapse in popularity during the past 16 months is unprecedented in the 54 years since the Gallup poll began measuring presidential approval ratings.

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It's amazing to me that almost all the world's stock indices are heading down, but despite that many US indices are breaking out to new record highs. I wouldn't have believed it could happen if I hadn't seen it with my own eyes. Can the divergence last? I dunno. It will be a good test of the old adage which states that "primary trends are international in scope." If the primary trend of stocks in the US is bullish, then how can Japan be in the throes of a major bear market? Maybe it's just one of those surprises I was talking about. Remember, I said 1992 will be the year of suprises.

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Is there something wrong with me -- I can't stand listening to Clinton's speeches. In my opinion, Clinton's the world's most boring speaker. If he says anything worthwhile, would somebody please wake me up and let me know. Meanwhile, the cartoonists are warming up for Big Bill (whose's been gaining weight and looking a bit juicy around the waist). Here's one example:

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Saddam Hussein is making fools out of Bush and the United Nations. Saddam pushes a violation to the extreme, then gives in just when the slow-moving UN finally threatens "to do something." Desert Storm is looking increasingly like Desert Disaster (now it turns out that we didn't even knock out the scuds during the Storm). Bush's refusal to finish off Saddam will go down as one of the biggest military/political blunders of all time.

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I bought that triple-dipple, around-the-clock, Olympic pay-in-advance $125 NBC package. And it was great. It's such a pleasure to see event after event with no advertising. However, NBC was shocked to see how few bought the package. I think they expected one million viewers to go the full $125. I heard that around 60,000 bought it.

Spare me any more boasting about our Olympic "Dream Team." C'mon, we invented basketball, then we send our top basketball professionals to Barcelona to beat a lot of other teams whose countries aren't even into basketball [Financial notes: Michael Jordan will make $21 million in endorsements alone this year. And former body builder, Arnold Schwarznegger (one of America's shrewdest businessmen), is getting $15 million plus to appear in a movie. It pays to be a genuine US folk hero].

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Can a nation or a corporation develop bad Karma? I believe so. Here's a headline from a piece in the July 24 *WSJ:* "White House Girds to Promote Huge Arms Sales to Many Nations." In my opinion, this is just plain disgusting. How can we ask other nations to cool it on arms when we're selling arms as fast as we can turn them out -- and just to boost our exports? What kind of international leadership is that? Talk about bad Karma! And what about the tobacco companies pushing as hard as they can to sell the world on cigarettes. Disgusting. The new area of sales -- Asia, where US tobacco companies are opening up new factories. Talk about Karma, do you remember the famous "Marlboro Man"? Well, he died of lung cancer last week at the age of 51. His name was Wayne McLaren. His last words were, "Take care of the children. Tobacco will kill you, and I'm living proof of it."

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Millionaires or just a cheaper dollar? At the start of the decade according to the IRS 4,414 taxpayers reported that they made a million dollars or more for the year. By 1990, 63,642 Americans said they made a million bucks that year.

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Gambling: Is America a nation of gamblers? Evidently. The figures show that in 1991 Americans gambled $304.1 billion at the casinos, the horse races and other sporting events. And this is only what was legal. Wagering at Indian reservations was $5.44 billion, the Nevada and New Jersey casinos wagering total was $149 billion, and state lotteries accounted for $20.9 billion. California, as usual, did not do well. The state's $1.81 billion in state lottery take was down 21% from the previous year.

You think all the above represents a load of money? What do you think world currency trading amounts to? Try $800 billion a day, every day. Now that, that's real money (compare it with roughly $12 billion a day traded on the NYSE).

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US car drivers represent a huge voting block, which probably explains why gas is so cheap here in the US. Note: oil drilling in the US is at its lowest level in 31 years, and, as usual, we buy most of our oil overseas. In Britain, gas is $2.98, in Germany it is $3.33, in Italy it's $4.28, in Japan it's $3.62. Europe taxes gas heavily. If the US slapped an one dollar additional tax on every gallon of gas sold in this country it would bring in $110 billion a year, knock our federal deficit down near 25% and cut down driving (which would help clean up the environment). But don't worry, that'll never happen.

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The Perot plans for eliminating the federal budget are drawing a lot of "oohs" and "ahs." I heard that when Perot saw how much pain (let's call it sacrifice) would be involved in eliminating the deficit, he decided there's no way anyone backing the plan could get elected -- so he quit. The plan involves higher taxes and major entitlement cuts. But at least it was a real plan, which is a lot more than either Bush or Clinton have offered.

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A cartoon labels "The Old Democrats" shows a guy with a sign saying "Tax and Spend." A second box labeled "The New Democrats" shows Clinton with a sign saying, "Revenue enhancement and entitlements."

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Why do horse-players lose? When you bet on the horses (unlike casino betting) you're not betting against the house. At the track you're betting against other bettors. But the track takes a flat percentage (usually around 17%), and the rest (83%) goes to the bettors. So on average the bettors pay the track a buck and get back 83 cents. With those percentages against you, you've got to be awfully good to be a winner, particularly if you keep playing. The slots in Vegas work the same way, but the return (the percentage returned is fixed by law) is somewhat better.

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The *Sindlinger* organization says that their Current Income Index (based on US family income) began to drop in September 1989. The latest figure for the Index, says *Sindlinger*, "is at the greatest negative extreme ever seen in *Sindlinger's* 38 years of continued daily household surveys." Maybe this has set off rumors that the Fed might drop interest rates even further. But if *Sindlinger's* figures are correct, the Fed would seem to be "pushing on a string." The Fed is saying that lower interest rates will bring in buying; *Sindlinger* is saying that the consumer is strapped, that no level of interest rates will bring in buying, the consumer wants to save and pay down bills, rather than buy. In the stock market they say, "Never fight the Fed." But evidently the American consumer hasn't heard that one.

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Compared with today's all-too-often cowardly and self-seeking politicians, the signers of the Declaration of Independence were real men and great patriots. You're skeptical? Then read these notations written on a tablet located at the home of Benjamin Harrison, one of the signers of the Declaration. "By signing the Declaration of Independence, the 56 Americans pledged their lives, their fortunes and their sacred honor. It was no idle pledge. Nine signers died of wounds during the Revolutionary War. Five signers were captured or imprisoned. Wives, children were killed, jailed, mistreated or left penniless. 12 signers' houses were burned to the ground. 17 signers lost everything they owned. No signers defected. Their honor, like their country, remained intact." This then, was the breed of men who made this nation great.

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From our "Enough, already" file: As if Californians haven't got enough troubles with riots, earthquakes, bankruptcies and a collapse in the state's credit rating, now a tiny insect called phylloxera is literally destroying the grape vines of the northern California wine country. The word is that growers may have to wipe out as much as two-thirds of their vines and then plant an insect-resistant vine . . . On top of the louse, there's the mouse. Orange County has been besieged by millions of mice. The mice population exploded on the good feeding provided by the spring rains. Now they're hungry and they're invading homes in San Juan Capistrano, San Clemente and Laguna Niguel. So far, the mice have not hit San Diego, but I'm waiting, white-knuckled.

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If the biggest trend in business is globalization (i.e., selling the world), why not buy the world's best international companies? Great idea, what are they? According to Michael Landry, president of the MacKenzie/Ivy Group of Funds they are (1) Coca Cola, (2) Merck, (3) Nestle, (4) Exxon, (5) Deutsche Bank, (6) Philip Morris, (7) Glaxo, (8) Schlumberger, (9) Union Bank of Switzerland, (10) Hanson. Let me add a few of my own. Royal Dutch, J.P. Morgan and Dairy Farm. Dairy Farm (an ADR) is the largest supermarket operator in Hong Kong, but it is extending its operations to Spain, Taiwan, Australia and the UK.

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On it goes: There are now two million more workers in government than there are workers in US factories. And as for cutbacks, according to *Forbes* (Aug 3) in the two years ended in June, state and local employees grew 2.5% to 15.6 million. In the same period, private (non-farm) payrolls shrunk by 2.2%.

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Clinton-Gore: According to the National Taxpayers Union, Al Gore voted for more spending than 92 of 100 profligate senators. Our new vice-president is one of the biggest spenders in recent memory.

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Good Idea: It looks as though New Jersey will have the first state law mandating that welfare mothers get nothing extra if they have another child while on welfare. The change will be effective October 1 unless it is reversed by a court. Sounds like a good idea to me. It's ridiculous for a mother on welfare to keep increasing the population at taxpayer's expense.

* *

You want to know why the states are going broke? (1) Exploding education costs. (2) Soaring Medicaid costs. (3) Accelerating crime, and accompanying rising costs of new prisons. (4) Rising costs to counties and cities (the states provide major cash infusions to the cities and counties). People can't believe what's happening to California. But people keep moving in by the thousands. Unfortunately, they aren't people with money.

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Statistics: The typical American family income in 1989 was $35,225. In 1990 58.6% of US families owned a home, and 43.9% of those homes were in the suburbs. 65.4% of the homes had a mortgage, and the average monthly cost was $737. The average American male is 5 feet 9.1 inches and weighs 172 pounds. The average female is 5 feet 3.7 inches and weighs 144 pounds. 71% of Americans read one newspaper a day. Americans watch 28 hours and 13 minutes of TV each week. 53.9 million US households own stocks or mutual funds.

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I was talking to my son, Ryan, who is 14 years old and just back from camp (where he fell in love with a girl from Northern California). I explained to him the fearful danger in contracting AIDS. "Darn it," he complained, "your generation spoiled it for my generation." I told Ryan that honest, I didn't have anything to do with creating AIDS. I also told him that in my day boys 14 didn't have sex, and believe it or not, some guys even waited until there were 18 or until they got married before having sex. He was shocked. Yep, it's a different world today.

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**RUSSELL'S MEGATRENDS:** There's a book out which describes what the author believes to be the coming "megatrends." I have my own ideas about coming megatrends and here they are:

(Force 1) The rise of China, with particular emphasis on Chinese outside of China. I've been writing about China as the coming wild card in the world economy, and the July 18 issue of the London *Economist* features an article on China with emphasis on the Chinese living outside China which they call "The Overseas Chinese." The article states, "China is a giant that could dominate the 21st century." Of the "Overseas Chinese", the article says, there are 55 million of them, they are family-oriented, they are workers, they are "prodigious savers and investors . . . In the Chinese parts of Asia savings rates run at 25% to 40% of GNP. Worldwide, the overseas Chinese probably hold liquid assets (not including

securities) worth $1.5 to $2 trillion. For a rough comparison, in Japan, with about twice as many people, bank deposits in 1990 totalled $3 trillion." Of Asia's four 'tigers', states the article, "only S. Korea is not Chinese." Let me put it this way, the Chinese, both in and out of China, are coming on like gangbusters.

(Force 2) The AIDS disease will affect the world in every way. The July 27 issue of *US New & World Report* features an article entitled "The Hidden Cost of AIDS." By the year 2000, says the article, "30 million to 100 million people will be carrying the HIV virus, up from 12 million today . . . But the worldwide economic cost of this vicious virus has been widely ignored . . . by the year 2000 the epidemic could drain between $356 billion and $514 billion from the global economy." In the US, AIDS could siphon off between $81 billion and $107 billion by the year 2000; in Africa and Asia it could cost up to 4.6% of the GDP. AIDS is sweeping the world. In Thailand 7% of new army recruits tested positive for HIV. In the sugar plantations of Haiti, 9% of the workers tested positive. In Uganda, 8.3% of the population is HIV positive. In Zambia one out of five miners has HIV. In India 6% of the truckers tested have HIV. Put it this way, AIDS is shaping up as the 20th century's answer to the Black Death. The situation is developing into a total horror story, and it's a story that is far from over.

(Force 3) The world capital squeeze. Every nation in the world appears to be running out of money. Everywhere you look you see deficits, from the cities to the states, from the US to Germany. It's a global squeeze, and the question is -- where's the money coming from? In the end, governments will have to print the money, but they can't seem to print it as fast as it's being spent. So debt is building, and the only question is which country is going to print the fastest. By the way, Force 3 represents an excellent argument in favor of gold.

(Force 4) The force of grim reality in the US. A report by the Children's Defense Fund indicates that real wages in the US have not risen since 1973. The minimum wage has not kept up with inflation. The US now has the highest divorce rate in the world; half of all marriages end up in the divorce court. Only 25% of families fit the old description of mom, dad, and two kids. 10 percent of America's children live without either parent (they live with relatives). Fifty percent of divorced men are behind in child support payments. And 20% to 25% of our high-school students don't graduate; in inner cities it's up to 60%.

And I ask myself, what the devil's going on? How did all this happen? My answer: it started with our government spending more than it takes in. They call the process deficit spending. When a government gives its people more than they are entitled to and more than they've produced, and the process goes on year after year, you create an economically unstable, morally untenable situation. As the process continues and becomes increasingly flagrant, the fiber and seams of the nation start to come apart. I think that's where we are now.

I'm old enough to remember -- back in the 1950s, we didn't have dope, we didn't have gangs, we didn't have filthy cities, we didn't have homeless sleeping in every doorway, we didn't have dead cops, we didn't have over-population, we didn't have killing taxes, we didn't have smog and pollution, we didn't have latch-key kids, we didn't have most mothers having to work, we didn't have acute cynicism towards government institutions, we didn't have "the incredible, shrinking dollar."

A government chronically in deficit is an immoral government, it's a government going against the laws of economics. Washington has been spending what it doesn't take in for decades. It's inflated this nation far beyond the nation's ability to sustain itself. The key word to describe conditions today is INSTABILITY.

Today, nobody can define what a dollar is worth because there's no longer a definition for the dollar; the dollar simply floats against other currencies. Today our currency is unstable, our political institutions are unstable, our social conditions are unstable, our markets are unstable. That's the new force of extreme instability. And it lends itself directly to another force -- speculation. Now everything is a speculation -- will the dollar be up or down today, will I have my job tomorrow, will I make it home tonight without getting mugged, will my kids get AIDS, will my state raise my taxes; you name it, it's up for grabs in the deficit-ridden "New America."

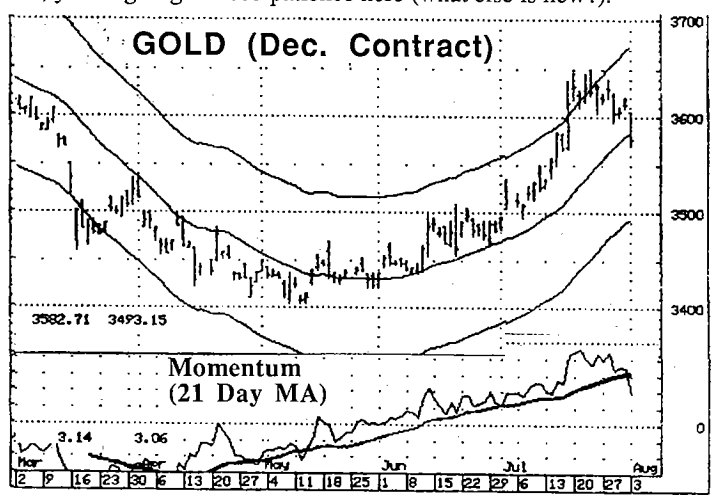
**GOLD:** The sentiment towards the gold stocks continues to be skeptical to outright bearish. I computed the short interest ratio in a number of gold stocks, and it was high. In each case the total number of shorts was divided by the average daily volume. I would say that the shorting in the gold shares was excessive. Here we go. American Barrick had the highest short interest ratio at 8.96. This means that the shorts in ABX were equal to the 8.96 days of average volume. Short interest in ASA was a high 5.39, Newmont Mining 1.68, Newmont Gold 3.36, Placer Dome 1.0, FMC Gold 1.99.

The primary trend is the strongest single force in the market. I can't prove it yet, but I suspect that after a 12-year bear market, the primary trend of gold is in the slow, tedious process of turning up. If that is true, then the one factor that would intensify the rise, the factor that will greatly enhance technical strength, is the factor of disbelief.

That's why I was interested in computing the short interest ratios in the gold stocks. A high short interest (particularly when compared with average daily volume) provides a good barometer of belief or disbelief. Based on the short interest ratios in the gold shares, I would say that there is a good deal of disbelief regarding any bull trend in gold.

In the meantime, the action in gold is hopeful in that it almost surely established a bottom, but discouraging in that the metal continues to produce its periodic swoons. The latest swoon came on August 3 as gold futures opened down four dollars.

Here's a chart of the December gold contract. Gold dropped just below its 21-day moving average (center channel line), but it's still well within the overall rising channel. Momentum or rate-of-change has broken below its 21-day moving average, so gold is now in its corrective phase. How this correction works out will tell us a lot about the overall technical position of the metal. If you're a gold bull, you're going to need patience here (what else is new?).




NEXT MAILING: Aug. 19, 1992

A biotech firm that wife Faye did legal work for invited us to Sedona, Arizona over last weekend. We flew into Phoenix, where the temperature was 112 in the shade. I mean it was HOT. From there we drove to Sedona, 125 cactus-covered miles away and up at around 4600 feet. Sedona is a breathtakingly beautiful spot, surrounded by mountains of bright red sandstone, mountains that have been formed by wind-erosion into weird, unearthly shapes. We took a Jeep ride into the mountains through some of the roughest terrain I've ever been in. Ah, night -- I habitually fall asleep with the radio on, and this time is was to "the 24-hour Voice of the Navajo Nation." Rock and roll interspersed with Indian drums and Navajo chants. I mean, it was an experience. If you go to Sedona, stay at the Enchantment Resort; it's pretty, comfortable and turns out outstandingly good food.